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SIPDIS

SENSITIVE

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TAGS: EAIR ELAB EU IT KPRV PGOV FAA AVIATION
SUBJECT: ALITALIA: RESTRUCTURING PLAN CLOSE TO APPROVAL

REF: A. ROME 2119
¶B. ROME 1734
¶C. ROME 1080

Sensitive but Unclassified. Please protect accordingly, not for Internet publication.

¶1. (U) Summary: Alitalia, the Italian government, and labor unions are expected to sign a final agreement soon on the restructuring of Italy's flag carrier. The airline will be split into two companies, one to continue the core flight operations, the other to take over Alitalia's ground services. Eventually both companies will be privatized, though, at least initially, most "private" investment will likely come from state-controlled holding companies and financial institutions. The unions successfully limited layoffs to under 3,700 (from an initial management proposal of 5,000) but otherwise made significant concessions on productivity. The Italian government will likely approve unemployment payments to those who lose their jobs, with Alitalia covering at least some of the costs. One Embassy contact at Alitalia headquarters believes the savings will be enough to return the company to profitability, possibly in preparation for a merger with Air France-KLM. However, the airline still faces major hurdles, including a shrinking slice of Italy's domestic market and costly airport services. End summary.

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Alitalia to Split Flight Operations, Ground Services
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¶2. (U) Alitalia, the GOI, and most of Alitalia's unions are expected to sign a final agreement to restructure Italy's flag carrier. Once the plan is finalized, Alitalia will receive a Euro 400 million ($480 million) government-guaranteed bridge loan. According to the agreement, in early 2005 Alitalia's core flight operations will be taken over by a new company "AzFly," which will continue to use the Alitalia brand name. Meanwhile, Alitalia's ground service operations will be placed in a second company, "AzService." Alitalia/AzFly will initially keep 51 percent of AzService, while the remaining 49 percent will be transferred to Fintecna, a holding-company 100 percent controlled by the Ministry of Economy and Finance. Alitalia/AzFly will keep its 51 percent stake of AzService up until privatization of AzFly, which is expected in June 2005.

¶3. (U) Under the plan, AzFly's recapitalization and privatization process will begin in March 2005. The Ministry of Economy and Finance will lower its ownership of AzFly from the current 62 percent to 30 percent. The Ministry, according to some news accounts, plans to remain the controlling shareholder even after it gives up its majority stake. Moreover, the privatization will likely be limited to government-affiliated institutional investors, at least until the company recovers enough to attract market-based buyers. According to press reports, Cassa Depositi and Prestiti, S.p.A. (CDP), a government-controlled joint-stock company connected to Italy's postal savings system, is a possible investor in a "privatized" AzFly.

¶4. (U) Emboffs recently spoke with representatives of Alitalia's major labor unions and an Alitalia executive to understand their respective views of the restructuring plan.

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Unions Meet Some of Their Goals, Limit Layoffs
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¶5. (U) Representatives of the three major union groups (CGIL, CSIL and UIL), which negotiated both new labor contracts and the final restructuring and financing of Alitalia into AzFly and AzService, expressed satisfaction, if not great enthusiasm, over the deal. On September 18, the unions approved the last of three labor contracts for pilots, flight attendants and ground crews. On September 24, eight of the nine unions representing 22,000 Alitalia workers signed off on the quasi-privatization of the company. One independent union representing attendants and ground crews, SULT, remains unhappy with both the lack of employment guarantees and the new company structure, but it is unlikely

that SULT will be able to block final agreement. Union leaders are still discussing how to present the deal to union members. They will organize either a referendum or consultations witin the next few weeks and expect their memberhips to approve the agreement.

¶6. (U) The unions had three primary goals: to minimize the number of overall layoffs; to prevent the government from privatizing AzService; and to win public support for finding other government jobs for the fired workers. Faced with impending bankruptcy and management's demands for greater labor productivity, they had mixed success in meeting these goals. Alitalia's President, Giancarlo Cimoli, initially predicted the company would need to fire 5,000 workers. Under the final agreement, 3,679 workers will lose their jobs resulting in a 315 million Euro reduction in labor costs; the majority of the losses will be in Lazio, Milan and some airports in the south. Because the new labor contract for pilots alters the formula for basic salary vs. incentives on productivity, Alitalia pilots will have to fly more hours to maintain current salary levels.

State Control Remains, For Now

¶7. (U) During the last week of negotiations, unions were focused on maintaining a high degree of government control over Fintecna in the hopes that political pressure could prevent further privatization and job loss. Under the deal, Fintecna, a public-owned company, will acquire 49% of AzService shares. However, Fintecna likely will restructure AzService and sell it to Finmeccanica, another state-owned company, but one that is due to be privatized shortly. The final agreemnt does not provide specifics on the ultimate fate of AzService, but Cimoli has stated that he wants to separate the activities of AzService and AzFly. AzFly's need for additional cash after 2005 will likely lead to the eventual privatization of AzService, an outcome which the unions fear will lead to additional job losses. Union leaders are also worried that AzService will be saddled with the bulk of Alitalia's debt, a charge the company denies. The deal received an initial nod from EU authorities, when EU Transport Commissioner Loyola de Palacio said on September 21, "the arrangement and agreement are a good sign."

Government Will Help 3,700 Laid-off Workers

¶8. (U) The agreement on unemployment benefits and training for dismissed workers will be signed by government, company and union representatives. Although UIL continues to press the government to hire the newly unemployed in other government jobs, the September agreement provides no such guarantees. In outlining the deal to Embassy officers, UIL negotiators said their members were resigned but hardly "singing for joy." Although there are fears over upcoming layoffs, unions expect their rank and file to accept some job cuts as a necessary condition to save the company. UIL representatives, who tend to be less dogmatic than CGIL or CISL advocates, expect that many of Alitalia's skilled workers will find new employment regardless of how the company is restructured. UIL is presenting the restructuring agreement as evidence of union flexibility in adapting to economic realities. In fact, the unions are concerned that management of a newly privatized AzService will exploit recently enacted labor market reforms that permit greater management flexibility in hiring part-timers and using lease contracts that may employ more people but with lower wages and fewer benefits.

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Management: Government Step-Aside Made Deal Possible
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¶9. (SBU) According to Olivier Jankovec, Director of Institutional Relations for Alitalia, the airline was able to win concessions from the unions because, unlike in the past, the Berlusconi government refused the unions' request to participate in a three-way negotiation, a format that has traditionally strengthened labor's hand. Jankovec said the GOI did pressure the company to adopt a softer line with the unions in early 2004, which led to the collapse of talks, an April strike by Alitalia workers that further damaged the company's bottom line, and the resignation of Managing Director Marco Zanichelli. Jankovec said the government was able to adopt a hands-off approach in September because the June 2004 EU Parliamentary elections had passed and because, as time wore on, more Italian political leaders realized that Alitalia was teetering on insolvency.

¶10. (SBU) Jankovec expected the government to formally designate the air transport sector as a "crisis industry," a move which would allow the government to pay unemployment benefits to the laid off workers (though Alitalia will likely

have to pick up some of these costs). Politically, Jankovec added, the rescue plan has a greater chance of succeeding because of the reduced hostility of Labor and Social Welfare Minister Roberto Maroni. Maroni is a member of the Northern League, a coalition partner that has traditionally opposed state aid to Alitalia, which the League views as a typically wasteful state enterprise designed to spread jobs and patronage to Italy's South. The League's change of heart, he said, is due to the financial difficulties of another Italian airline, Volare, which is based in the League stronghold of Vicenza. Volare, Jankovec explained, will probably need to conduct its own restructuring, and any plan given to Alitalia workers must be extended sector-wide.

"Savings Enough to Turn Alitalia Around"

¶11. (SBU) Jankovec expressed optimism that the new union contracts will result in enough savings to return Alitalia to profitability. He said the deal with the pilots union, which would raise the maximum number of hours pilots could fly per year to over 900 (on a par with Lufthansa), is the most significant. Alitalia also intends to eliminate backup pilots on many trans-Atlantic flights, a practice long adopted by most of its competitors. The airline will also cut back on perks such as free home-to-airport transportation and will eliminate a policy of allowing Alitalia crews to live in one city yet fly out of another, a system which forces the Airline to provide 11,000 free seats per year to shuttle employees from home to their duty stations. Finally, Jankovec said, Alitalia will need to work with local governments and airport authorities to reduce the costs of airport services. Jankovec commented that jet fuel typically costs 20 to 30 percent more in Italy than in other European countries because fuel distribution in Italy is an inefficient and highly-protected industry.

Goal #1: Regain Domestic Market Share

¶12. (SBU) Jankovec said Alitalia's main priority is to regain its once-dominant position in the Italian market. The airline's domestic market share has dropped 16 percent since 2000 and is currently hovering around 43-44 percent. However, Jankovec remarked, Alitalia's ultimate goal remains an eventual merger with another major European carrier. Air France-KLM has expressed interest in merging with Alitalia if it ever manages to get on a sound financial footing.

Comment

¶13. (SBU) Breaking Alitalia in two and selling the pieces to state-controlled holding companies and institutional investors hardly amounts to a true privatization, yet it may be the best option for a government trying to sell a bankrupt state carrier while maintaining as many jobs as possible. The nearly 3,700 in staff cuts is significant, but is far shy YQQ8QQ9Qr oof the 10,000 layoffs some outside observers believe will be necessary to make the airline truly viable (ref A). Nevertheless, Jankovec believes that this "Italian privatization" will at least offer some degree of insulation from the kind of direct political interference that over the years has contributed to Alitalia's bloated payroll and inefficient operations.

¶14. (U) Overall, the Alitalia deal is a blow to Italian unions, which for the last 30 years provided their members with a steady increase in wages and benefits. UIL negotiators bristled at the question of whether the concessions contained in the agreement may be the wave of the future. They preferred to consider the agreement as a reflection of the global problems facing the airline industry and were not unhappy to be in the company of U.S. workers with troubled carriers like U.S. Airways. However, the fact that the unions were willing to negotiate on the premise of

job cuts and required improvements in labor productivity could mark a significant change for labor-management negotiations in other Italian industry sectors in the future. Certainly, the Berlusconi government is pleased with the deal, which, while hardly freeing the government of its near-term obligations to Alitalia, opens the way for further privatization.

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